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SUBJECT: Large German Banks Expect Government to "Invite" them into Stabilization Fund

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REF: A. BERLIN 1452, B. FRANKFURT 3102, C. BERLIN 1414

¶1. Summary: In what would be an about-face in government policy, senior managers at large German banks expect the Finance Ministry to "invite", or require, institutions to accept capital injections rather than accept funds on a voluntary basis. Such a change would overcome a perceived weakness of the German rescue plan: since participation is optional, those that take part are stigmatized, while other players avoid accepting funds at all cost. Despite some reluctance to give up independence, private bank executives argue that the change would make sense as it mirrors the packages in other major economies and would ensure that the playing field remains even between German banks and international competition. The executives said they expect the change to take place before the end of the year, although it could be both politically and operationally difficult to carry out. End Summary.

Financial Market Stability Fund Creating Stigmas

¶2. On October 29, Office of Management and Budget Deputy Director Stephen McMillin hosted a roundtable with senior German financial executives to discuss ongoing financial developments in the U.S. and Europe. After Mr. McMillin gave an overview of the situation in the U.S., the conversation turned to Germany and Europe. The executives unanimously expressed the opinion that the Finance Ministry must change its Financial Market Stabilization Fund (FMSF), whereby banks can decide whether or not to accept capital injections (Ref A). To date only troubled banks, such as BayernLB, WestLB, HSH Nordbank and Hypo Real Estate, have asked for funds. Commerzbank Chief Risk Officer Wolfgang Hartmann, whose bank has considered tapping into the fund, argued that the fund currently "stigmatized" these banks, while others refused to take part to preserve their reputations. He felt the Finance Ministry would alter the FMSF to "invite" (meaning require) Germany's biggest banks to accept capital injections by the end of the year.

¶3. Deutsche Bank Global Head of Capital Management Rainer Rauleder said forced participation in the program "would not be so bad" fro his bank, but that otherwise Deutsche Bank had no need for capital injections: it was "doing fine" and had secured funding through the end of 2009. With over 2 trillion euros ($2.5 trillion) in assets, Deutsche Bank is Germany's largest bank and focuses on global markets and investment banking. Deutsche Bank CEO Josef Ackermann recently generated headlines by reportedly telling senior management that he would be "ashamed" if his bank needed to tap government funds (Ref A). Comment: Despite its apparent sure footing, Deutsche Bank would probably have to be included in any list of required participants due to its size and symbolic importance as Germany's leading bank and Rauleder's comments indicated that he acknowledged this reality. End Comment.

Differences in Plans Distort the Market

¶4. Several bankers argued that the change in the FMSF was necessary to even the playing field in the European financial sector. Morgan Stanley Managing Director Christian Zorn pointed out that while the British and German rescue packages included severe penalties for participating institutions, the French plan offered capital at "a nicer price." Such differences between national plans would bring distortions to the sector and artificially enhance the competitiveness of French banks. He feared that Germany's approach was not sufficiently prescriptive and that German competitiveness would lag if banks continued to refuse to accept capital.

¶5. Zorn also pointed out that requiring the largest banks to accept capital injections would have less impact in Germany than elsewhere due to the dispersed nature of Germany's financial sector. Injecting capital into only the largest banks would capture less of the market than in other countries where large banks dominate; it would therefore be less effective.

Political Way Forward Also Difficult

¶6. The participants also asserted that it would be politically challenging to change the FMSF at this point. The ruling CDU-SPD Grand Coalition has been widely praised for its handling of the crisis to date, but inviting the largest banks into the fund would not only be another political U-turn, but could generate debate on the fund's "fairness" if it excluded smaller banks. Finance Minister Peer Steinbrueck would have to avoid creating the impression that he was favoring large banks, which in many cases are not in dire straits and are still profitable.

¶7. JPMorgan Chase Managing Director Martin Wiesmann felt punitive aspects of the plan, such as the 2% premium in return on capital, would have to be relaxed if large banks were invited in, as profitable banks should not be forced to pay such fees. Such a change could also generate outcry in the public as it would create the impression that banks were being let off the hook for profligate behavior. The bankers argued that the markets were punishing the financial sector enough already, but acknowledged that the public did not sympathize with this argument.

¶8. Comment: The conversation was notable in that all participants agreed that the German government would soon "invite" (i.e., compel) large banks to accept capital injections and that such a move was necessary although it would limit the independence of large banks. Sources at the Association of Private Banks in Berlin had hinted earlier in the week that this might be a possibility. Even perennial lone-wolf Deutsche Bank saw this option as better than the alternative: a loss of relative German competitiveness in the European market and a slower recovery. End Comment.

¶9. This cable was coordinated with Embassy Berlin and cleared with OMB.
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